Bank of Canada cuts again, but easing may slow from here

US tariffs are clouding the Canadian outlook, and the Bank of Canada has trimmed rates by 25bp to 2.75% today in line with expectations. The message is not unidirectionally dovish though, as inflationary concerns are also rising. We expect only one more cut and remain moderately bearish on the Canadian dollar in the near term

Bank of Canada Governor, Tiff Macklem

A tariff-led cut

The Bank of Canada has cut its policy rate 25bp to 2.75%, as expected. This brings the cumulative amount of interest rate cuts to 225bp since June last year. This is despite surprisingly strong fourth-quarter 2.6% annualised growth after an upwardly revised 2.2% print for the third quarter and stronger employment growth in the November-January period. Instead, the Bank believes that first-quarter 2025 growth will “likely slow” with tariff concerns weighing on sentiment and activity, while February job growth has already stalled.

The Bank continues to acknowledge “more than usual uncertainty” due to trade tariffs and has a sense that this uncertainty is “restraining consumers’ spending intentions and businesses’ plans to hire and invest." After all, 76% of Canadian exports go to the US, equivalent to 20% of Canadian GDP – so even a modest drop in exports could risk a recession.

Inflation concerns can slow pace of cuts

As such, this latest move appears to be an insurance cut to try and protect against the downside risks for the economy. However, with core inflation above target and inflation expectations creeping higher, the Bank warns that it will be "carefully assessing the timing and strength of both the downward pressures on inflation from a weaker economy and the upward pressures on inflation from higher costs".

It does not offer any new guidance on where policy is heading, but our assumption is that the pace of cuts will slow after today's move, and forecast just one further rate cut coming in the second quarter.

FX: BoC not the primary driver for now

The Canadian dollar was only marginally impacted by a consensus BoC rate cut and lack of forward guidance. If we were to speculate on the content of the statement, the sentence that reads "monetary policy cannot offset the impacts of a trade war" may be viewed as a slightly hawkish signal compared to where rate expectations are.

Markets are still pricing in two rate cuts by year-end, with 10bp factored in for the 16 April meeting. This is more dovish than our baseline scenario, but a hawkish repricing in rate expectations looks unlikely until data offers some clarity on the US tariff impact or the trade spat deescalates.

We therefore see any support from an eventual adjustment higher in the BoC terminal rate expectation only coming through in late spring, if not later. USD/CAD should continue to trade closely in line with US tariff news. Despite already trading around 2% above its short-term fair value, we expect some USD restrengthening leading to USD/CAD appreciation beyond 1.450.

Author

James Knightley
Chief International Economist, US
james.knightley@ing.com

Francesco Pesole
FX Strategist
francesco.pesole@ing.com